Equity Market Update

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To start the year, our investment team predicted 2015 would be a volatile year for equity markets. The first quarter lived up to that prediction..

The total return for the S&P 500 was 0.95%. It marked the ninth quarter in a row the index was positive. In the last three months, the S&P 500 experienced 19 occasions in which the daily value swung by 1% or more, the most since mid-2012.

Volatility extended far beyond the S&P 500. The Dow Jones Industrial Average had a total return of 0.33%. The NASDAQ was the best performer among large cap indices, led by advances in biotech and social media stocks. It jumped 3.86% in the quarter.

Mid-cap and small-cap companies also had a bumpy ride in the first quarter, but posted strong gains. The S&P Mid-Cap 400 Index returned 5.31%, while the S&P Small-Cap 600 Index advanced 3.95%.

Gains were also seen internationally. The EAFE Index returned 5.04%, led by European stocks benefiting from the Euro-currency's largest quarterly percentage drop ever. The MSCI Emerging Markets Index jumped 2.22%.

Stocks continue to respond favorably to historically low interest rates around the world. According to the *Wall Street Journal,* 17 global stock indexes set all-time highs in the first quarter, while 29 more indexes hit multi-year highs.

The volatility in the equity markets is coming from possible diverging monetary policies between the Fed and the other major central banks around the world. With US economic activity improving, especially in employment data, the Federal Reserve has been sending signals they may be ready to raise interest rates from 0%, their first move in almost seven years. With the other major central banks around the world still inflating assets with quantitative easing programs, global investors have rushed to buy the US dollar.

Since August of last year, the US dollar has gained 18.64% versus a basket of other world currencies. In just the last three months, the dollar has strengthened almost 10% against the Euro. The large advance by the dollar is a problem for big, US-based mulitnational companies. These firms see their profits shrink when international sales are converted back to US dollars for financial reporting purposes. With most of these companies being members of the Dow and the S&P 500, these indices underperformed other equity indexes during the quarter.

On a sector basis, healthcare and consumer discretionary stocks are far outpacing companies in other

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sectors. Consumer discretionary stocks are being aided by the steep decline in energy prices--U.S. crude prices are down 56% since last June. With that being said, energy companies underperformed the overall market for the third straight quarter; however, investors did begin buying oil and gas companies betting the worst of the storm had passed. Utilities were the worst performers as investors shed these stocks fearing an interest rate hike by the Fed is on the horizon.

Of our managed portfolios, Core World was the best performer in the quarter. The portfolio's large positions in developed and emerging economies led to its outperformance. Equity Income was a laggard in comparison to our other styles. The portfolio's emphasis on dividends, along with a larger holding of multinational companies when compared to our other styles, hurt its performance as the US dollar rallied and investors prepared for a potential Fed rate hike.

Looking forward, earnings season is on the horizon. Analysts have been bringing their quarterly and full-year numbers down in anticipation of lackluster earnings from the rising dollar. Although economic data has been somewhat of a mixed bag recently, our internal economic checklist continues to indicate the US economy is still slowly improving.

We believe volatility will remain heightened for equities. A rising US dollar, potential for a Fed interest rate hike and elevated stock market valuations will be the reasons for the bumpy ride. At the current time, the S&P 500 is trading at 16.7x 2015 estimated earnings, which is well above the 10-year average of 14.1x. We believe a premium to the historical average is warranted given the abnormally low interest rates; however, this does make stocks vulnerable to unexpected events.

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